

Charitable Foundation Lease

Minimizing Rent, Property Taxes, and Lease Liabilities
Maximizing Economic and Operational Control



NEWMARK

Cf The **CENTURION** Foundation, Inc.
A non-profit organization

■ ■ HALL
■ RENDER
KILLIAN HEATH & LYMAN

Executive Summary

- **Current Situation:**

- Accounting rules changes now put lease obligations on the balance sheet
- “Lease vs. Own” now favors ownership-type lease financing structures
- Not-for-profit health systems increasingly seek “control” of core properties
- For-profit and REIT landlords’ financial interests are mis-aligned with the charitable mission of not-for-profit healthcare providers

- **Response:**

- New and unique, “ownership-like” structures offer significant advantages over traditional third-party landlord leasing structures
- Effective solutions will:
 - + Maximize property control (economic and operational)
 - Minimize balance sheet burden (lowest lease liability)
 - Minimize impact to net income (lowest rent and property tax)

SOLUTION

The Charitable Foundation Lease (“CFL”) via The Centurion Foundation

- Replace traditional landlords with a transparent and independent Charitable Foundation “owner” who is **mission-aligned** with tenant
- **Rent levels are 30-60% lower** than landlord leases
- **Lease liabilities are 40-70% lower** than landlord leases and direct ownership
- 501(c)(3) “owner” **mitigates/avoids property taxes** in most states
- Tenant retains full operational and economic **control** of properties (ownership)
- Centurion Foundation, a 501(c)(3), is fully **transparent and independent** (NOT aligned with or influenced by any developer, landlord, or real estate firm)
- Long-term **value** of properties is **retained by the non-profit tenant** through favorable fixed purchase options and Centurion’s “donative intent” charter

LEASE COMPARISON

Sample MOB Case - \$30MM, 60,000 SF

<u>Structure</u>	<u>Term</u>	<u>Rent Factor</u>	<u>Tenant's IRR</u>	<u>Yr 1 Rent/SF</u>	<u>Lease Liability</u>	<u>Purchase Option</u>	<u>RVG?</u>	<u>Property Taxes?</u>
1. For-Profit Landlord Lease	15	6.00%	7.90%	\$30.00	\$24,786,187	Fair Market Value	No	Yes
2. Full Amortization CFL	25	5.20%	4.00%	\$26.00	\$30,000,000	\$1	No	No
3. Walk Away CFL	20	6.25%	3.85%	\$31.72	\$26,219,297	\$9,000,000	No	No
4. Hybrid CFL	15	3.75%	3.75%	\$18.75	\$12,729,708	\$30,000,000	Yes	No
5. Ownership	15	5.00%	3.00%	\$25.08	\$30,000,000	N/A	No	No

Notes

- Hybrid CFL assumes no amortization, tenant may choose to amortize if desired.
- Landlord Lease IRR assumes 6.00% cap rate value at lease end.
- Ownership Rent Factor = Principal and Interest, IRR = Debt Rate, Liability = Debt Balance

Recent Selected Projects



Joint Venture Rehabilitation Hospital

- Joint venture (JV) rehabilitation hospital between a national health system and a national operator
- JV controls design and construction
- \$1.4 million reduction in annual rent vs. traditional developer/REIT options
- Total savings over the initial lease term of **\$51 million**, rent savings of \$20 million, and \$31 million in savings via favorable purchase options



MultiCare Health Sale Leaseback

- Four, free-standing emergency departments Sale/Leaseback
- 20-year lease term with \$100 purchase option at end of lease
- \$1.0 million annual reduction in rent and property tax expense
- Total savings over the lease term of **\$125 million**, rent savings of \$7 million, property tax savings of \$16 million and \$102 million in savings via favorable purchase options



Hartford HealthCare MOB Restructure

- Acquired seven properties from existing landlords, structured new 10-15 year leases, \$142 million portfolio
- Lease liability reduction of over \$30 million
- \$3 million annual reduction in total expense
- Total savings over lease term of **\$50 million**, rent savings of \$39 million, property tax savings of \$11 million



Boston Medical Center Administrative Office Building

- \$43 million property acquisition plus \$15 million in tenant improvements
- Lease liability reduction of over \$30 million
- \$2.4 million annual reduction in rent expense and tax vs traditional developer lease
- Total rent and tax savings over life of lease of **\$17 million**

What is a Charitable Foundation Lease?

- **CFLs** are ownership-type financings that may be classified as Operating Leases or Finance Leases at the tenant's preference (vetted with all major accounting firms)
 - 501(c)(3) Charitable Foundation is the titled "Owner"
 - The Charitable Foundation is **funded 100% by credit-oriented debt investors** (banks, insurance companies, pension funds, bond market)
 - 7-30 year initial lease terms
 - Pricing based on tenant's credit using favorable taxable and/or tax-exempt interest rates
 - Interest-only or amortizing lease profile at tenant's discretion
 - Absolute NNN, bond-type lease

What is a Charitable Foundation Lease?

- **End of Term Options for the Lessee:**
 - **Purchase** the property at a fixed price equal to the Charitable Foundation's outstanding debt (the "Lease Balance"), if any
 - **Renew/Refinance** lease at rate sufficient to refinance the Lease Balance, if any (NOT at FMV)
- **CFL Structural Options:**
 - **"Full Amortization" CFL** – Funding is fully repaid over the lease term, title reverts to the tenant for \$1 at lease maturity.
 - **"Walk Away" CFL** – Lease amortizes to a favorable fixed purchase option amount, and the tenant also has the option to walk away from the lease with no obligation at lease maturity
 - **"Hybrid" CFL** - Interest-only or limited amortization lease, at lease maturity the tenant may purchase or renew/refinance the lease at the outstanding lease balance. A third option is to walk away from property subject to *Residual Value Guarantee* ("RVG") from the tenant. **RVGs are not capitalized into the tenant's Lease Liability** under new FASB and GASB lease accounting guidelines which generates the lowest possible rent and lease liability profile.

CFL – BEST OF BOTH WORLDS

Characteristics of a Charitable Foundation Lease: “Best of Both Worlds”

	<u>OWNERSHIP</u>	<u>CFL</u>	<u>TRADITIONAL LEASE</u>
Cost of Capital	Low	Low	High
Property Tax	Low	Low	High
Tenant Economic Control	High	High	Low
Tenant Operational Control	High	High	Low
Balance Sheet Impact	High/Medium	Low	Medium/Low
Income Statement Impact	High/Medium	Low	Medium/Low

Accounting Profile of Charitable Foundation Leases

- **Lease Classification** – Lessees/Tenants should **include** the full amount of the Residual Value Guarantee (RVG) in the present value of fixed lease payments when evaluating lease classification under ASC 842-10-25-2(d), Operating Lease vs Finance Lease
- **Lease Capitalization** – Lessees/Tenants should **exclude** the present value of an RVG from the present value of Right of Use Asset/Lease Liability as long as there is no expected payment (i.e. the value of the property supports the RVG). Lease payments for capitalization purposes include only amounts probable of being owed under the RVG (ASC 842-10-30-5, 842-20-30-1)
- **Expense Profile** – Operating Leases and Finance Leases result in the same capitalization but have different expense profiles. Hybrid Leases can be structured to meet either classification depending on desired expense profile
 - Operating Lease is straight line, recorded as an operating expense
 - Finance Lease is front-loaded, declining over time but below EBITDA line

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